LEBOEUF, LAMB, GREENE & MACRAE
L.L.P.
A LIMITED LIABILITY PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

NEW YORK
WASHINGTON, D.C.
ALBANY
BOSTON
DENVER
HARRISBURG
HARTFORD
HOUSTON
JACKSONVILLE
LOS ANGELES
NEWARK
PITTSBURGH
SALT LAKE CITY
SAN FRANCISCO

260 FRANKLIN STREET
BOSTON, MA 02110-3173
(617) 748-6800
FACSIMILE: (617) 439-0341
E-MAIL ADDRESS: MEABH.PURCELL@LLGM.COM
WRITER'S DIRECT DIAL: (617) 748-6847
WRITER'S DIRECT FACSIMILE: (617) 897-9047

LONDON
(A LONDON-BASED MULTINATIONAL PARTNERSHIP)
PARIS
BRUSSELS
JOHANNESBURG
(PTY) LTD.
MOSCOW
RIYADH
(AFFILIATED OFFICE)
TASHKENT
BISHKEK
ALMATY
BEIJING

December 5, 2003

BY HAND

Mary L. Cottrell, Secretary
Massachusetts Department of Telecommunications
and Energy
One South Station, 2nd Floor
Boston, MA 02110

Re: Fitchburg Gas and Electric Light Company; EC 03-3

Dear Ms. Cottrell:

Enclosed, please find Fitchburg Gas and Electric Light Company's responses to the Department's First Set of Data Requests in Docket EC 03-3. Please note that only two copies of the attachments to DTE-1-2 are being provided because of the size of the attachments.

Thank you for your attention to this matter.

Very truly yours,

Meabh Purcell

Meabh Purcell

MP:rtm

Enclosures

cc: Caroline M. Bulger, Hearing Officer (1 copy)
Miguel Maravi (4 copies)
Robert Sydney, General Counsel, DOER (1 copy)
Wilner Borgella, Assistant Attorney General (1 copy)
Ted Bohlen, Assistant Attorney General (1 copy)
Paul Muzyka, PGM Plastics (1 copy)
Michael Lanava, Executive Director (1 copy)

Bs92187

Commonwealth of Massachusetts
Department of Telecommunications and Energy
Fitchburg Gas and Electric Light Company
Docket No: EC 03-3
Department's First Set of Data Requests

Request No.: DTE-1-1

Please refer to the Letter at 4 and Letter at Att. 3. Explain how the proposed exclusion of the fixed cost from the marginal costs as filed in D.T.E. 02-24/25 and the calculation of a marginal variable cost comply strictly with D.P.U. 96 39-A at 2 (October 27, 1998), which states that a distribution company must demonstrate that "the discounted rate exceeds the Company's marginal cost of distribution" before the Department will approve an electricity contract, especially in light of the fact that this finding does not limit marginal costs to a company's marginal variable cost.

Response:

FG&E submits that its methodology for calculating marginal costs is appropriate and generally consistent with D.P.U. 96-36-A, because it reflects the marginal cost of distribution for this customer. The marginal costs as filed in D.T.E. 02-24/25, without adjustment, do not give a proper representation of the marginal costs to serve PGM. The filed marginal costs reflect a system wide average, and though it provides an appropriate computation in many cases, in certain instances and locations the average costs may not be representative. As discussed in the cover letter to FG&E's special contract filing, PGM has an existing facility currently operating, and is expanding operations into an adjacent, previously vacant facility. The distribution system in place does not need to be expanded to meet the customer's needs. The only work required to serve the expansion load was an upgrade in the service to the facility, which was reflected in FG&E's marginal cost computation.

Additionally, FG&E reviewed its capacity situation with respect to this load, and does not anticipate any upgrades within a reasonable time horizon as a result of this load expansion. The PGM load represents approximately 20 percent of the capacity of the distribution circuit they are on. Even after the expansion of this load and a 5 year growth projection were applied, the circuit remains at less than 70 percent of capacity. FG&E estimates that there is more than adequate capacity on this distribution circuit and that there will be no need for an upgrade within the next 5 to 8 years.

Taking this into consideration, FG&E determined that the fixed marginal costs to serve PGM are $0, and has, therefore, adjusted its marginal costs as filed in D.T.E. 02-24/25 accordingly.[1] By excluding these fixed costs, the resulting marginal cost computation acknowledges the current and projected capacity of the specific distribution circuit. The only costs that will be incurred to serve PGM are variable expenses, and these will be more than fully recovered in the proposed rate.

Person Responsible: **Karen M. Asbury**

---

[1] In D.P.U. 93-41, the Department recognized the effect of excess capacity on marginal costs. In considering Boston Edison Company's recommendation to allow the use of short-run marginal costs as the lower bound, the Department noted that in extended periods of excess capacity, any capacity costs included in a long-run marginal cost study will be significantly discounted . Id. at 35.

Commonwealth of Massachusetts
Department of Telecommunications and Energy
Fitchburg Gas and Electric Light Company
Docket No: EC 03-3
Department's First Set of Data Requests

Request No.: DTE-1-2

Please explain if the Company is proposing a departure from the Department's findings in D.P.U. 96-39-A (October 27, 1998) to address such fixed cost exclusion from the marginal cost study proposed in its filing. Also, explain if there are decisions that support the Company's precedents in the regulated industry for the proposed fixed cost exclusion of fixed costs from the marginal cost study to obtain Department approval of a discounted rate in a Special Contract?

Response:

As explained in FG&E's response to DTE 1-1, FG&E believes its proposed methodology is a reasonable application of the Department's precedent in D.P.U. 96-39-A, in light of the particular circumstances of this case.

FG&E is aware of decisions of public utility commissions in several jurisdictions which appear to be supportive of the premise that a special contract should be approved if it provides for recovery of all variable costs while also providing for some contribution to fixed costs.[2] A full copy of each decision is attached, and an excerpt of the relevant portion is provided below.

Attachment DTE 1-2 (1). *Re Louisville Gas and Electric Company*, 204 PUR4th 196, 2000 WL 1791791 (Ky.P.S.C. 2000):

> LG&E has demonstrated that its special contract class is contributing to the system's fixed costs even though the class's rate of return is significantly lower than the total system return proposed by LG&E. As we have found several times in reviewing gas or electric utility special contracts or economic development rate proposals, if rates are sufficient to cover variable costs plus make a contribution to fixed costs, the system as a whole and the remaining customers benefit. In the absence of the special contract/large volume customers' contribution, the remaining customers' rates would require a further increase sufficient to cover those fixed costs. Recognizing that competition, in addition to cost of service, plays a role in revenue allocation, the Commission finds it reasonable to allocate none of the increase awarded herein to the special contract class. However, the Commission will continue to monitor LG&E's special contract filings and advises LG&E that the prices contained therein will continue to be subject to extensive review. (*Slip Op.* at 45.)

Attachment DTE 1-2 (2). *Re Missouri Gas Company*, 1997 WL 233139 (Mo.P.S.C. 1997):

> As part of its compliance filing, MGE's tariffs shall reflect the three- pronged standard adopted by the Commission in Case No. GR-95-160 and reiterated here. The tariff shall

---

[2] Please note that the sponsoring witness is not offering a legal opinion as to the relevance of the cited decisions. Rather, these citations are provided in an attempt to be responsive to the data request and assist the Department with its review and consideration of FG&E's request.

Request No.: DTE-1-2 (cont. Page 2)

> reflect that any special contract arrangements: (1) were necessary to avoid imminent bypass; (2) recover variable costs plus a reasonable contribution to fixed costs; and (3) in instances involving affiliates, was at arm's length and flexes rates no lower than necessary to meet relevant competition. (*Slip Op.* at 35.)

Attachment DTE 1-2 (3). *Re Consumers Power Company,* 159 P.U.R.4th 409, 1995 WL 114109 (Mich.P.S.C. 1995), affirmed, *Consumers Power Company, Appellant, v. Michigan Public Service Commission*, 226 Mich.App. 12, 572 N.W.2d 222, 184 P.U.R.4th 408 (Mich. Ct. of Appeals 1997):

> Based on the record and arguments of the parties, the Commission concludes that the contract should be approved. There is an adequate evidentiary basis to conclude that James River has an economic bypass alternative and that the special contract rates are necessary to induce it to remain as a customer on Consumers' system. There is also an adequate evidentiary basis to conclude that the rates in the special contract will cover the variable costs of serving James River and will provide a contribution to system fixed costs. Consumers' management considered these factors and decided to enter into the special contract as the best deal that could be obtained for the utility. The Commission therefore approves the resulting contract. (*Slip Op.* at 11.)

Attachment DTE 1-2 (4). *Re Electric Services, Market Competition, and Regulatory Policies*, 163 P.U.R.4th 131, 1995 WL 542483 (Md.P.S.C. 1995):

> In order to ensure the judicious use of special contracts and rate flexibility, the Commission will establish guidelines to ensure that they are used only in circumstances that result in net benefits for all utility customers. First, any special rate should recover customer-specific variable costs and some contribution to fixed costs. Without this requirement, the utility might be put in the anomalous position of supplying a customer at a loss. Thus, remaining customers would actually be worse off by retention of the customer. This would nullify one of the most important rationales for special contracts. That is, that even though a special rate for one customer may ultimately raise rates for those without competitive options, those customers are still better off than if the special rate customer left the system altogether.
>
> Second, the utility seeking approval of a special contract must demonstrate that the special rate customer in fact does have viable competitive alternatives. These alternatives may include the opportunity to exploit a market-based price offered the customer, or the ability to self-generate or relocate.

Commonwealth of Massachusetts
Department of Telecommunications and Energy
Fitchburg Gas and Electric Light Company
Docket No: EC 03-3
Department's First Set of Data Requests

Request No.: DTE-1-2 (cont. Page 3)

Third, while the Commission understands that special contracts may result in cost-shifting, it will not permit excessive rate increases for other customers. Accordingly, it may be appropriate in some instances for shareholders to bear some of the burden for these special contracts. (*Slip Op.* at 25)

Person Responsible: Karen M. Asbury

Commonwealth of Massachusetts
Department of Telecommunications and Energy
Fitchburg Gas and Electric Light Company
Docket No: EC 03-3
Department's First Set of Data Requests

Request No.: DTE-1-3

Please refer to the Letter, at 4 and Letter at Att. 3. Explain if the discount rate proposed to be offered to PGM Plastics, Inc. will comply strictly with G.L. 164, 1C, where it says " all products, services, discounts, rebates, and fee waivers offered by a distribution company shall be available to all customers and suppliers simultaneously, to the extent technically possible, on a comparable basis." Please explain if the Company is planning to offer the same discount to all customers. Why or why not?

Response:

The provision in the data request above is a provision that was required to be addressed by the Department in the context of developing standards of conduct for distribution companies and their affiliates. G.L. 164, §1C provides, in part, that the Department ". . . shall promulgate standards of conduct which shall ensure the separation. . ." of any marketing affiliate from any generation, transmission or distribution company affiliate of an electric company. The standards adopted pursuant to this statutory section are found at 220 CMR 12.00, titled "Standards of Conduct for Distribution Companies and Their Affiliates." More specifically, with respect to the quote above, see 220 CMR 12.03 (6) (b), which states that "If a Distribution Company offers a Competitive Affiliate, or a customer of a Competitive Affiliate, a discount, rebate or fee waiver for any product or service that is subject to a tariff on file with the Department, it shall make the same simultaneously available to all Non-affiliated Suppliers and their customers simultaneously, to the extent technically possible, on a comparable basis." Since PGM is not a customer of a Competitive Affiliate, this provision does not apply.

In any event, the nature of a "special contract" is to enable a utility company to offer service at an off-tariff rate to a customer who presents unique circumstances, where such rate can be shown to be consistent with the interest of the utility's remaining ratepayers. To the extent that another customer of FG&E presents the same or similarly situated circumstances, the Company would certainly consider whether a special contract was warranted. FG&E, however, would not automatically offer the same discount as provided in the instant case, as it would attempt to arrive at a formula that maximized contribution to fixed costs while accommodating the needs of the customer in order to retain them or allow them to expand. Additionally, FG&E believes that the Department's requirements for special contracts provide sufficient protection to guard against free riders.

Finally, FG&E's understanding of 220 CMR 12.03 (6) (b) is that if PGM was a customer of a Competitive Affiliate, the same discount would apply to customers of Non-affiliated Suppliers when there are comparable circumstances.

Person Responsible: **Karen M. Asbury**

Commonwealth of Massachusetts
Department of Telecommunications and Energy
Fitchburg Gas and Electric Light Company
Docket No: EC 03-3
Department's First Set of Data Requests

Request No.: DTE-1-4

Please discuss why the Company believes that "sunk costs" should be removed from the marginal cost study in the evaluation of a special contract.

Response:

FG&E believes that sunk costs should be removed from the marginal cost study in the evaluation of a special contract, since when costs are considered sunk, the only costs that will be incurred to use the distribution system are variable costs. As long as special contract rates cover these variable expenses and make some contribution to fixed costs, customers are better off. This is not to say that fixed marginal costs are always sunk. For example, when costs will be incurred to serve new customers in the area, the fixed costs should not be considered sunk and an appropriate marginal cost assigned in evaluation of a special contract.

Person Responsible: **Karen M. Asbury**